OPINION NO. 992

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DISTRICT OF COLUMBIA TAX COURT

GENERAL MOTORS CORPORATION, Petitioner,	)	
vs.	)	DOCKET NOS. 1698 and 1699
DISTRICT OF COLUMBIA, Respondent.	)	

FINDINGS OF FACT AND OPINION

These two cases have been consolidated for hearing and disposition. They involve the same questions of taxation for the calendar years 1957 and 1958. The assessing authority of the District of Columbia assessed the petitioner substantial franchise taxes. The petitioner here appeals from the assessments and claims that they are invalid. The respondent insists that the assesaments are proper and justified under Title X of the District of Columbia Income and Franchise Tax Act of 1947.(1)

FINDINGS OF FACT

Most of the facts are stipulated and, together with exhibits, are found as stipulated.

The Court finds additional facts for the taxable years involved as follows:

1. The petitioner had business establishments in 38 states and the District of Columbia. The principal office or headquarters of the petitioner was in Detroit, Michigan. There was an oxecutive office in New York City in which were located the financial executives of the petitioner.

2.(a) The factories of the petitioner were located principally in the states of Michigan, Ohio, Illinois, Indiana, New York, New Jersey, Delaware, Maryland, Missouri, California

(1) Title X of Chapter 15 (Sections 47-1580 and 47-1580a), D. C. Code, 1951 Edition.

and Georgia. There was no factory or assembly plant of the petitioner in the District of Columbia.

(b) Approximately fifty per centum of petitioner's physical properties, including factories, equipment and inventories, and payroll amounts were located or paid in Michigan.

(c) All Cadillac automobiles and all heavy trucks of the petitioner's GMC and Coach Divisions were manufactured in Michigan. In addition, many component parts of automobiles and quantities of Buick, Oldsmobile and Pontiac automobiles were manufactured in that state.

(d) At the petitioner's factory or plant in Maryland there were assembled Chevrolet automobiles for shipment to the District of Columbia and the surrounding states.

(e) At the petitioner's factory or plant in Delaware there were assembled Buick, Oldsmobile and Pontiac automobiles for shipment to the District of Columbia and the surrounding states.

3. The petitioner in accordance with the statutes of the respective states filed income tax returns and paid income taxes for the taxable years involved as follows:

YEAR	STATE	AMOUNT
1956	Delaware	$127,844.95
1957	Maryland	510,792.31
1958	Maryland	271,425.75
1957	Michigan	8,955,799.55
1958	Michigan	18,130,000.00

4. At a conference between the representatives of the petitioner and of the Finance Officer of the District of Columbia, after notice of the latter's intention to assess the deficiencies here involved, the representatives of the petitioner protested the contemplated assessment and stated that the apportionment made was out of all proportion to the

business carried on in the District by the petitioner; and that the formula used was basically unfair because it did not take into consideration or employ factors which were important in the production of income from manufacturing; and suggested that factors other than sales should be employed in apportioning the income of the petitioner and suggested that the property and payroll factors should be considered.

Opinion

The assessing authority of the District of Columbia assessed the petitioning taxpayer deficiencies in franchise tax and interest as follows: for the calendar year 1957 a deficiency of $268,585.40, plus interest of $35,379.40 or a total of $303,964.80; and for the calendar year 1958 a deficiency of $167,468.44, plus interest of $11,860.89 or a total of $179,329.33. The total amount of both deficiencies, $483,294.13, was paid by the petitioner. These appeals followed. The petitioner claims that the deficiencies and interest in their entirety were erroneously assessed. On the other hand, the respondent contends that they were validly assessed.

For the reasons hereafter stated the Court holds that deficiencies and interest for the two taxable years in the total amount of $327,049.23, were erroneously assessed against, and collected from the petitioner.

Before stating the reasons for the above holding, the Court will consider and dispose of the constitutional questions raised by the petitioner to the extent that it is empowered so to do.

I

Constitutional Questions

The petitioner has raised two constitutional questions, namely, that in violation of the Constitution (a) the

application of the formula results in the taxation by the District of Columbia of values without its borders or taxing jurisdiction, and (b) the provision of the statute which exempts or relieves from taxation those corporations or unincorporated businesses which have no office, warehouse or place of business in the District, while imposing a tax on those who do have an office, warehouse or place of business in the District is unconstitutionally discriminatory. The Court does not believe it can decide those questions because of the muddled condition of the status of the Court, that is to say, whether it is a court or an administrative agency.

It is clear that Congress attempted to make the Board of Tax Appeals a court, or, at least, take away its administrative function as "a constituent member of the assessing authority"by the Act of July 10, 1952, (see third paragraph of Section 47-2402, D. C. Code, 1961 Edition). Such attempt, however, has been held to be abortive.

In Hesmer v. District of Columbia, 77 U. S. App. D.C. 295, 135 F.2d. 654, 71 W.L.R. 932, Judge Prettyman held that the then Board of Tax Appeals was not a court, but "a constituent member of the assessing authority". He held the same in Hamilton National Bank v. District of Columbia, 85 U.S. App. D.C. 109, 176 F.2d 624, 77 W.L.R. 1102. After those two decisions Congress attempted, at least, to negative or correct the effect of those decisions by providing in the Act of July 10, 1952, making the Board of Tax Appeals the "District of Columbia Tax Court", that "the said District of Columbia Tax Court shall not be deemed or held to be a constituent member of the assessing or taxing authority of the District of Columbia". In a recent case, District of Columbia v. Brady, 109 U.S. App. D.C. 324, 288 F.2d 108, Judge Prettyman, however, held as follows:

"Moreover, under the Code, the ultimate exhaustion of the administrative remedy, i. e., a decision by the Tax Court, an 'independent agency' in the District Government, or indeed even the filing of an appeal with that Court, precludes the taxpayer from filing suit under his common-law remedy. If the exhaustion of the administrative remedy is a bar to a common-law action a fortiori it can in no sense be a condition precedent to such a suit.

"We conclude that Dr. Brady's failure to exhaust his administrative remedy did not preclude his bringing action in the District Court."(2)

The Tax Court of the United States is by the organic Act, a designated administrative agency.(3) In several cases in that Court it was held that it could decide constitutional questions, although serious doubts about that function have been expressed by some of the judges of that Court. This Court is, however, uncertain as to its power to decide a constitutional question and believes that until the matter is more clearly or definitely settled by the United States Court of Appeals or by a declaratory act of Congress, it should not decide the questions, but merely note, as it here does, that the constitutional questions were here raised. The Court, therefore, will decide the other issues presented under the law as it exists.

II
The Basis for Taxation

These cases involve franchise taxes imposed by Section 47-1571a of the Code,(4) which provides as follows:

"For the privilege of carrying on or engaging in any trade or business within the District and receiving income from sources within the District, there is hereby levied for each taxable year a tax at the rate of 5 per centum upon the taxable income of every corporation, whether domestic or foreign."

The question which the Court must answer is: what is the portion of the petitioner's net income that was fairly attributable to the trade or business carried on by it within

(2) It is interesting to note that the same result would have occurred from a holding that the Tax Court was a court and not an administrative agency.

(3) Actually it is a court. There is, and has been for sometime, a movement to have it declared to be a Federal Court.

(4) Section 2 of Title VII, D. C. Income and Franchise Tax Act of 1947.

the District of Columbia during the taxable years involved, 1957 and 1958, and other net income from sources within the District - within the meaning of that part of Section 47-1580[5] reading as follows:

> "****. The measure of the franchise tax shall be that portion of the net income of the corporation *** as is fairly attributable to any trade or business carried on or engaged in within the District and such[6] other net income as is derived from sources within the District; * * *."

The question presented in these cases relates solely to that segment of the petitioner's business which involves the manufacture of a certain number of automobiles and kindred products outside the District of Columbia and the sale thereof to customers within the District. To use the language of the many regulations, the trade or business contemplated by the Act is "the manufacture and sale or purchase and sale of tangible personal property". The Commissioners have correctly interpreted the term "trade or business" to include a combination of either "manufacture" and "sale" or of "purchase" and "sale". Otherwise, the regulations would have read "manufacture, purchase or sale". (See, among others, Section 10-2(c)(1)(a), Regulations of August 6, 1953.) The regulations in the respect indicated are consonant with the legally established fact that, "income may be defined as the gain derived from capital, from labor, or from both combined" Strattons Independence, Ltd. v. Howbert, 231 U.S. 399, 415, 58 L.Ed. 285, 34 S.Ct. 136; Doyle v. Mitchell Bros. Co., 247 U.S. 179, 185, 62 L.Ed. 1054, 38 S.Ct. 467; Eisner v. Macomber, 252 U.S. 189, 207, 64 L.Ed. 521, 40 S.Ct. 189. (And we might add "enterprise".) The cases, Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 65 L.Ed. 165,

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(5) Section 1 of Title X, ibid.
(6) The word "such", apparently was ineptly inserted. It has no meaning or significance.

41 S.Ct. 45 and Bass, Ratcliff and Gretton, Ltd., v. State Tax Com., 266 U.S. 271, 69 L.Ed. 282, 45 S.Ct. 82, have frequently been cited to support one factor formulas, and in that connection they will be discussed with other similar cases in a later portion of this opinion. At this point they are cited to show that the "trade or business" with which we are here concerned includes both the manufacturing as well as the selling of the merchandise involved; that the net income therefrom is earned by both activities (7); and that, while net income is not "realized" until sale, it is earned in part by the manufacture of the article sold. In the Underwood Typewriter Co., case (254 U.S. at page 120) is the following: (8)

> "The profits of the corporation were largely earned by a series of transactions beginning with manufacturing in Connecticut and ending with sale in other states."

Likewise in the Bass, Ratcliff & Gretton case (266 U.S. at page 282) we find this:

> "So in the present case we are of opinion that as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places - the process of manufacturing resulting in no profit until it ends in sale, etc." (Emphasis supplied.)

And as the Supreme Court said in Hans Rees' Sons v. North Carolina, 283 U.S. 123, 75 L.Ed. 879, 51 S.Ct. 385:

> "Undoubtedly the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits."

III

Regulation and Formula Must Comply with Law

At the outset it should be pointed out that, legally, any formula or method for the apportionment or determination of

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(7) Together, of course, with administrative activities.
(8) Similar to the petitioner herein.

net income taxable by the District must, in respect of multi-state businesses, accord with that part of Section 47-1580a of the Code, which is in this language:[9]

> " * * * *. If the trade or business of any corporation * * * is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article be deemed to be income from sources within and without the District. * * * *." (Emphasis supplied.)

In McCeney v. District of Columbia,[10] 97 U.S. App. D.C. 282, 285, 230 F.2d 832, 84 W.L.R. 625, Judge Washington, commenting on the failure of the Commissioners to follow the statute in promulgating regulations, said:

> "Section 47-1601 is explicit that the tax is to be paid on the 'market value' of the interest involved. This requires, we think, that the actual market value of the interest be determined as nearly as possible. Although Section 47-1607 provides that the value of the remainder interest is to be determined by subtracting from the value of the property the value of the life interests, determined in such manner as the Commissioners' regulations prescribe, this does not authorize the Commissioners to adopt regulations which result in disregarding the directive of the statute to tax only the market value of the interest. It is axiomatic that administrative rules must be consistent with the statute under which they are promulgated." (Emphasis supplied.)

See also: Manhattan General Equipment Co. v. Commissioner, 297 U.S. 129, 134, 80 L.Ed. 528, 56 S.Ct. 397; Addison v. Holly Hill Fruit Products, Inc., 322 U.S. 607, 616, 88 L.Ed. 1488, 64 S.Ct. 1215; Thompson v. Amalgamated Casualty Ins. Co., 207 F.2d 214, 220.

Any formula or method which does not conform to, or comply with the plain and unambiguous directive or mandate of the law is, therefore, not legally permissible. For instance, if a corporation manufactures its products at its only plant in Maryland and sells them in the District, a formula with sales as the sole factor would be illegal, because under it the entire net income would be assigned to, or deemed to be from

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(9) Section 2 of Title X, District of Columbia Income and Franchise Tax Act of 1947.
(10) Involved an inheritance tax.

sources within the District. Likewise, if property be the sole factor, the formula would be legally improper, because all of the net income would be thereunder assigned to, or deemed to be from sources in Maryland.

It is interesting to note that, if the taxpayer has its office, manufacturing plant or other principal place of business in the District and sells some of its products or performs some of its services without as well as within the District, a formula with one factor of sales only does not necessarily violate the letter of the provision of the law that the income must be deemed to be from sources both within and without the District. Examples of that result are District of Columbia v. Southern Railway Co., 107 U.S. App. D.C. 285, 277 F.2d 84, 88 W.L.R. 277; District of Columbia v. Evening Star Newspaper Co., 106 U.S. App. D.C. 360, 273 F.2d 95, 87 W.L.R. 1371; and Thompson's Dairy, Inc. v. District of Columbia, D.C.T.C., Docket Nos. 1731 and 1733, Opinion No. 988. In those cases a one factor formula was used, but its use resulted in loss of revenue to the District to which it was economically entitled from the use by the taxpayers of property and administrative services within the District. A formula with the factors of property, payroll and sales would have saved that revenue, which no doubt, is why the Finance Officer of the District has repeatedly requested and urged the Commissioners to adopt the three factor formula for consistent use, that is to say, for the taxation of both resident and non-resident taxpayers.(11)

It should, moreover, be observed at this point that the provision for regulations apply in the statute to instances only where the net income of the taxpayer is "deemed to be income from sources within and without the District". Section 47-1580a of the Code, in part, provides:

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(11) Formal submission of the three factor formula to the Commissioners and action thereon will appear from the Appendices A, B and C to this opinion.

"Where the net income of a corporation or unincorporated business is derived from sources both within and without the District,(12) the portion thereof subject to tax under this article shall be determined under regulation or regulations prescribed by the Commissioners." (Emphasis supplied.)

Apparently, where the business is carried on solely in the District and the entire net income arises therein regulations or formulas are not necessary. They are only needed where the income is to be deemed to be from sources both within and without the District.

There are two suggestions or insinuations that need comment. The first is that, if all of a corporation's products manufactured outside the District are not sold therein, a one factor formula of sales would meet the requirement of the law, since it could be said that a part of the net income from the (entire) business of the corporation is deemed to be from sources without the District. The fallacy of that idea is due to overlooking the fact that the "trade or business" covered by the act is that relating to the District, which is a combination of "manufacturing and selling" and which is carried on in the manner stated in the Underwood Typewriter Co., and Bass, Ratcliff & Gretton cases, above cited, both within and without the District. To use an extreme case as the acid test, in Smoot Sand & Gravel Co. v. District of Columbia, 104 U.S. App. D.C. 292, 261 F.2d 758, 85 W.L.R. 1078, all of the taxpayer's products were manufactured or processed without the District. Ninety-five per centum was sold in the District, and that percentage of its net income was held to be taxable by the District under a one factor(13)

(12) That is to say, when the business is carried on within and without the District. See preceding portion of Section 47-1580a of the Code.

(13) The U. S. Court of Appeals evidently overlooked the mandate of the statute as to apportioning the income within and without the District, or it may have been influenced by the fact that Smoot Sand & Gravel Company had its principal office in the District where all of its fiscal affairs were handled. Two-thirds, however, of its expenses were incurred in Maryland and Virginia.

formula of sales. If all of the products had been sold, one hundred per centum of its income would have been held taxable by the District under that formula.

The other suggestion is that since not income results from the deduction from gross income of all expenses, including those relating to manufacturing, the requirement for the apportioning of net income within and without the District, where the business is carried on both within and without the District, is met by reason of such deduction. That suggestion, in the first place, overlooks the fact that all expenses, including that relating to selling the products, are deducted. Moreover, what we are trying to do in these types of cases is to find the locale of the commercial activity and what portion of the net income is fairly attributable thereto. The usual computation of net income involving the inclusion of items in gross income and deducting items of expense therefrom is not here involved. For practical purposes what is important in cases of this kind is the determination of what portion of net income results from the use of property, from the activities of administration and the like and from the process of selling.

For the reasons stated the Court does not believe that a one factor formula of sales can, consistent with the Act, be used where, as here, the trade or business involved is the manufacture of tangible personal property without, and the sale thereof within the District.

IV

The Eastman Kodak Company and the Panitz Cases

A great deal of confusion has arisen concerning a case decided some years ago by the United States Court of Appeals under the old District of Columbia Revenue Act of 1939, namely Eastman Kodak Co. v. District of Columbia, 76 U.S. App. D.C. 339, 131 F.2d 347. In that case this Court, then the Board

of Tax Appeals, uphold an income tax against Eastman Kodak Company on the entire net income from sales of its products in the District of Columbia. The amount of net income allotted to the District was computed by assigning to the District that proportion of the taxpayer's income as sales in the District bore to sales everywhere. The United States Court of Appeals affirmed that holding. Several things must be kept in mind in relation to the Eastman Kodak Company case and to these cases. They arose under two differing statutes namely, the District of Columbia Revenue Act of 1939, and the District of Columbia Income and Franchise Tax Act of 1947, respectively. The taxes imposed on corporations by the two acts are different in several important and essential respects. Flint v. Stone Tracy Co., 220 U.S. 107, 55 L.Ed. 389, 31 S.Ct. 342. The former imposed, as far as corporations were concerned, a pure income tax, while the latter levies a privilege tax, measured, it is true, by net income. The Eastman Kodak Company case was decided, certainly in this Court, on the severance theory, that is to say, that no income was earned until the property involved was sold - that "the fruit must be shaken from the tree", to speak figuretively; and that the place wherein the sale took place was where the income was realized. This Court and the Court of Appeals relied upon several Federal cases which were decided before the enactment of Section 119(c) of the Internal Revenue Code of 1939 (February 10, 1939).(14) The Federal law, as it existed earlier, and upon which those cases were based, was essentially the same as the District of Columbia Revenue Act of 1939. Section 119(c) of the Internal Revenue Code of 1939, however, materially changed the Federal law; and

(14) See the cases cited in Footnote 6, 76 U.S. App. D.C. page 340.

provided that income "from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, or produced (in whole or in part) by the taxpayer without and sold within the United States, shall be treated as derived partly from sources within and partly from sources without the United States", which is substantially what that part of Section 47-1580a quoted above provides, as far as this case is concerned, that is to say, involving the manufacture of personal property without, and its sale within the District. It is interesting to note that Eastman Kodak Company sought to have the United States Court of Appeals determine the question of tax liability on the basis of the then new Section 119(c) of the Internal Revenue Code of 1939, but that Court refused to do so and as stated above affirmed the above mentioned decision of this Court.

It should here be noted that the most important, and indeed, controlling difference between the District law involved in the Eastman Kodak Company case and the District of Columbia Income and Franchise Tax Act of 1947 is that the former law did not, as does the latter (Section 47-1580a of the Code) provide that where the taxpayer's business is carried on within and without the District the net income, for the purpose of measuring the tax, must be deemed to be from sources within and without the District. Another difference between the 1939 and 1947 District laws is that under the former, since the income was earned where the sale was made, the passing of title, which usually completes a sale of personal property, was determinative, while under the latter, the passing of title is of no determinative effect, which was due to, or came about by the following. The decision in the Eastman Kodak Company case in favor of the District was a Pyrrhic Victory. The manufacturers

quickly adopted a plan whereby title and possession of goods shipped from points outside to customers within the District passed to the customers at a point outside the District. The United States Court of Appeals in Electric Storage Battery Co. v. District of Columbia, 81 U.S. App. D.C. 135, 155 F.2d 867, set aside a District of Columbia income tax where the title to goods in a f.o.b. shipment passed to the customer outside the District. That and other cases, and the effect of the Eastman Kodak Company case and its use by the manufacturers resulted in the promotion by the District of the enactment of the District of Columbia Income and Franchise Tax Act of 1947,(15) which, as far as corporations and unincorporated businesses are concerned, has two principal advantages to the District, namely, nullification of the effect of the passing of title and the elasticity of a franchise tax which could be measured by income attributable to business carried on in the District, regardless of the locale of the sale or the real source of income in the concept of pure income taxation. Congress did, however, as above observed, provide, as protection for multi-state businesses, that where the business was carried on both within and without the District the net income from such business had to be considered income from sources without, as well as within the District.

Panitz v. District of Columbia, 74 U.S. App. D.C. 284, 122 F.2d 61, 69 W.L.R. 891, has been frequently cited in support of a one factor formula of sales. Like the Eastman Kodak Company case, the law involved in the Panitz case was materially different from the Income and Franchise Tax Act, - even more so. The Panitz case arose under the old Business Privilege Tax Act in the District of Columbia Revenue Act of 1937. It simply imposed

(15) Chapter 15 of Title 47, D.C. Code, 1951 Edition.

an excise tax measured by gross receipts from business carried on in the District "without any deduction therefrom on account of the cost of the property sold, the cost of materials, labor or services or other costs * * * or any expense whatsoever". All that was there decided was that a tax on the gross receipts from the commercial activity of sales (as required by the law) in the District was proper. There was no provision in the taxing statute requiring any apportionment, as does the present law, nor any provision similar in the slightest degree to the requirement in the current Act that, if the business is carried on both within and without the District, the net income must be apportioned accordingly.

The provision in Section 47-1580a of the Code providing that, if the trade or business is carried on within and without the District of Columbia, the net income must be deemed to be income from sources without, as well as within the District, has not only been ignored in the regulations, but has received no comment by counsel for the District in their brief in this case, although this Court has repeatedly referred to that provision as not only important, but controlling as well. The Court is at a loss to understand the failure on the part of counsel to discuss the provision in relation to these cases and to the facts stipulated by the parties.

V

Other Cases Cited to Support a One Factor Formula

Several Supreme Court cases have frequently been cited to support a one factor formula in the taxation of net income or gross receipts from unitary businesses or corporations. The cases do support the use of such a formula, if the particular statute so provides. In none of the cases did the taxing statute provide, as does the District law, for the apportionment

within and without the taxing jurisdiction where the business is carried on within and without that area. The cases, briefly discussed, are the following:

Maine v. Grand Trunk Rwy. Co., 142 U.S. 217, 35 L.Ed. 994, 12 S.Ct. 121. Really not an apportionment case. The method to be used was specifically spelled out in the Maine statute.

Underwood Typewriter Co. v. Chamberlain, supra. Unlike or exactly opposite from the District statute, the Connecticut law specifically provided that, if the business was carried on both within and without the State, the tax should be computed by the use of a one factor formula of property within Connecticut.

Bass, Ratcliff & Gretton, Ltd., v. State Tax Commission, supra. The taxing statute provided specifically for a one factor formula of real and personal property in New York.

National Leather Co. v. Massachusetts, 277 U.S. 413, 72 L.Ed. 935, 48 S.Ct. 534. Taxing statute specifically provided for use of a one factor formula of real and personal property employed in business in Massachusetts.

It should be added that in respect of the Underwood Typewriter Co., Bass, Ratcliff & Gretton, Ltd. and National Leather Co. cases the Supreme Court in the Hans Rees' Sons v. North Carolina, supra, indicated, as did our Court of Appeals in Smoot Sand & Gravel Co. v. District of Columbia, supra, that the decisions sustaining the one factor formulas turned largely upon the failure of evidence. This is what the Supreme Court said in the Hans Rees' Sons case.

> "* * *. Evidence which was found lacking in the Underwood and Bass Cases is present here. These decisions are not authority for the conclusion that, where a corporation manufactures in one state and sells in another, the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either state. In the Underwood Case, it was not decided that the entire net profits of the total business were to be allocated to Connecticut because that was the place of manufacture, or, in the Bass Case, that the

> entire net profits were to be allocated to New York because that was the place where sales were made. In both instances, a method of apportionment was involved which, as was said in the Underwood Case, 'for all that appears in this record, reached, and was meant to reach, only the profits earned within the state.' The difficulty with the evidence offered in the Underwood Case was that it failed to establish that the amount of net income with which the corporation was charged in Connecticut under the method adopted was not reasonably attributable to the processes conducted within the borders of that state; and in the Bass Case the Court found a similar defect in proof with respect to the transactions in New York." (Emphasis supplied.)

New York v. Latrobe, 279 U.S. 421, 73 L.Ed. 776, 49 S.Ct. 377. Unlike the District law, the New York statute specifically provided that the license fee for a corporation be based upon that proportion of its corporate stock that gross assets employed within the state bore to its gross assets employed everywhere. It was a corporate stock valuation case.

Ford Motor Co. v. Beauchamp, 308 U.S. 331, 48 L.Ed. 304, 60 S.Ct. 273. Unlike the District statute, Texas Annotated Civil Statute, Article 7084 specifically imposed "a franchise tax * * * based upon that proportion of the outstanding capital stock, surplus and undivided profits, plus the amount of outstanding bonds, notes and debentures, other than those maturing less than a year from date of issue, as gross receipts from its business done in Texas bears to the total gross receipts of the corporation from its entire business, * * *."

International Harvester Co. v. Evatt, 329 U.S. 416, 91 L.Ed. 390, 67 S.Ct. 444. The Ohio statute specifically provided the formula to be used. Incidentally, the Ohio statute provided a two factor formula, namely, of property and "business done" in Ohio.

Actually, all that the foregoing Supreme Court cases decided was that the use of the formulas specifically provided in the various statutes did not violate the Constitution.

A state case, Household Finance Co. v. State Tax Com., 212 Md. 80, 128 A.2d 640, relied upon to support the use of

a one factor formula should be briefly discussed. That case really supports the principle that, if business is carried on within and without the District the net income must be deemed income within and without the District. The Maryland statute required the State Tax Commission, in the valuation of corporate stock relating to Maryland, to exclude business and property outside the state. The order of the State Tax Commission did not follow the law. On appeal to the Court of Appeals of Maryland the order of the Commission was modified to comply with the law. Moreover, a statutory formula or method was provided.

VI

Expert Testimony

Both parties hereto produced expert witnesses in the field of economics. The petitioner's experts testified that in their opinion no income resulted from sales in themselves, but solely from manufacture and administrative activities; and that the proper factors to be used in a formula for the apportionment of net income of a multi-state manufacturing corporation are those of property and payroll. Diametrically opposed was the testimony of respondent's expert witnesses, who were of the opinion that the entire income of such a corporation was earned by sales, and that the only factor to be used in the formula was one of sales. Both sets of witnesses were in error. Income of corporations of the class to which the petitioner belongs results from all three activities. Of course, as observed in the Bass, Ratcliff & Gretton, Ltd. case, the income is not realized or received until the sale, but that does not mean that it is not earned as well by the other activities. For the reason stated the Court has made no finding on the subject matter of the experts' testimony.

Moreover, the plain and unambiguous directive in the Act concerning apportionment, would seem to render such testimony immaterial.

The Court has made no finding in relation to the testimony of the petitioner's expert witnesses to the effect that the assessment in this case resulted in attributing to the District a percentage of income out of all proportion to business transacted by it therein, because such testimony was immaterial in light of the Smoot Sand & Gravel Co., case, where it appeared that all of the activities of production occurred, and approximately two-thirds of expenses of operation were incurred outside the District, but ninety-five per centum of the net income was held taxable by the District.

VII

The Gallant Case

District of Columbia v. Gallant, Incorporated ____ U.S. App. D. C. ____, 290 F.2d 745, dealt with a regulation adopted by the Commissioners on August 6, 1953, for the enforcement and administration of the foregoing provisions of the Income and Franchise Tax Act.(16) The portion of the regulation with which we are here concerned is Section 10-2(c). The first sentence comports with the Act. It is the following:

> "If the trade or business is carried on or engaged in wholly within the District, the entire net income from trade or business shall be allocated to the District." (Emphasis supplied.)

The next portion of the regulation, Subsection (1)(a) of Section 10-2(c), attempts to prescribe, or has for its sole purpose the prescribing of a formula for the determination of the net income taxable by the District, that is to say, "fairly attributable" to any trade or business carried on in the District.

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(16) Chapter 15 of Title 47, D. C. Code, 1951 Edition.

The United States Court of Appeals in the Gallant case held that the subsection was valid, but that it failed in its purpose, or, to use the language in the opinion, "failed to provide a 'formula' as the term is ordinarily understood in the regulation". Later in the opinion is found this language (290 F.2d at page 748):

> "However, irrespective of the authority of the Assessor, the Tax Court itself cannot be precluded, for lack of a regulatory formula, from determining the income which is fairly apportionable to the District. Cf. McCeney v. District of Columbia, 97 U.S. App. D.C. 282, 230 F.2d 832 (1956). The Tax Court is, under Section 47-2403, to hear and determine 'all questions arising' on the appeal - here the question of what income is fairly attributable to the District - and it may 'reduce or increase' the assessment as required under its determination of such questions.
>
> "The case is remanded to the Tax Court for further proceedings not inconsistent with this opinion. The Tax Court is directed to determine the amount of the income which is fairly attributable to the District by applying the August 6, 1953, regulations, including if necessary the use of such formula or formulae as the Tax Court deems best suited for determination of that question in this case. * * *."

In Footnote numbered 4, relating to the regulation of August 6, 1953, is the following: "If a valid and pertinent regulation is promulgated by the Commissioners, the Tax Court must obey it and properly apply it." It is not supposed that the Court of Appeals meant that any regulation adopted by the Commissioners relating to the subject matter here involved should be given retroactive effect in face of the well established principle that such cannot be done if, as decided in the Gallant case, there was a valid regulation in effect during the prior year. District of Columbia v. Radio Corporation of America, 98 U.S. App. D.C. 119, 232 F.2d 376, 84 W.L.R. 918, cert denied, 352 U.S. 845, 1 L.Ed. 2d 51, 77 S.Ct. 44. But assuming that the United States Court of Appeals might have intended an exception or relaxation of the rule and intended that any new regulation be given retroactive effect, as was assumed in this Court's Memorandum on Remand in the Gallant case, this Court is of

the opinion that, for the reasons stated in that memorandum, to which reference is here made to avoid repetition, the regulation adopted by the Commissioners on July 14, 1961, purporting to relate or pertain to the foregoing provisions of the Income and Franchise Tax Act (See Sections 47-1580 and 47-1580a of the Code) is invalid. The principal objection to the July 14, 1961, regulation is that to apply it in this case to the trade or business involved would violate the plain and unambiguous provision of Section 47-1580a of the Code that "If the trade or business of any corporation * * * is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article, be deemed to be income from sources within and without the District."(17) The Court is of the opinion, therefore, that the use of the July 14, 1961, regulation in this case would be improper.

VIII

The Best Suited Formula

In the light of the Gallant case, the Court believes that it is its duty to determine the amount of net income that was fairly attributable to the District of Columbia within the meaning of Section 47-1580 and 47-1580a of the Code, and to use such formula or formulae as will be agreeable to, and not violative of any provisions of those sections. This Court assumes, of course, that the United States Court of Appeals requires that in adopting a formula this Court follow

(17) It is important to note that the use of the phrase "within and without the District" shows that the term "trade or business" includes that which is done without as well as within the District, otherwise the provision would be meaningless or at least, unnecessary, since there would never be any occasion for its use.

all pertinent provisions of the taxing statute. With that in mind and considering the nature and extent of the trade or business carried on by the petitioner in relation to the District, that is to say, the manufacture of a certain quantity of products and administrative activities without the District and the sale of those products within the District, the Court is of the opinion that a formula is necessary for the determination of the portion of petitioner's net income which was fairly attributable to business carried on within the District within the meaning of Section 47-1580 and 47-1580a of the Code; and that the formula best suited for that determination is the following:

> The portion of petitioner's net income fairly attributable to the trade or business carried on or engaged in within the District of Columbia by the petitioner during the taxable years 1957 and 1958 shall be determined by multiplying its total net income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.
>
> 1(a) The property factor is a fraction, the numerator of which is the average value of the petitioner's real and tangible personal property owned or rented and used by the petitioner in the District during the taxable year, except property from which petitioner derived net income subject to direct allocation under the regulations pertaining to the District of Columbia Income and Franchise Tax Act of 1947,[18] and the denominator of which is the average value of all the petitioner's real and tangible personal property owned or rented and used during the taxable year.
>
> (b) Property owned by the petitioner is valued at its original cost. Property rented by the petitioner is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the petitioner, less any annual rental rate received by it from sub-rentals.
>
> (c) The average value of property shall be determined by averaging the value at the beginning and ending of the taxable year.
>
> 2(a) The payroll factor is a fraction, the numerator of which is the total amount paid in the District during the taxable year by the petitioner for compensation, and the denominator of which is the total compensation paid everywhere during the taxable year.

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(18) For example, real estate rented to tenants, the rents therefrom being "such other income as is derived from sources within the District", within the meaning of Sections 47-1580 and 47-1580a of the Code, the net income from which is taxable separately from that derived from "trade or business". D.C. v. Evening Star Newspaper Co., 106 U.S. App. D.C. 360, 273 F.2d 95, 87 W.L.R. 1371.

(b) Compensation is paid in the District, if:

(i) The individual's service is performed entirely within the District.

(ii) The individual's service is performed both within and without the District, but the service performed without the District is incidental to the individual's service within the District, or

(iii) Some of the service is performed in the District and (1) the base of operations, or, if there is no base of operations, the place from which the service is directed or controlled is in the District, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in the District.

3(a) The sales factor is a fraction, the numerator of which is the total sales by the petitioner in the District during the taxable year, and the denominator of which is the total sales by the petitioner everywhere during the taxable year.

(b) Sales of tangible personal property are in the District if:

(i) The property is delivered or shipped to a purchaser, including the United States, within the District of Columbia, regardless of the f.o.b. point or other conditions of the sale.

The foregoing formula is, incidentally, substantially similar to the formula provided for multi-state businesses in the Uniform Division of Income for Tax Purposes Act,[19] and to that recommended by the Finance Officer to the Commissioners in a memorandum dated March 22, 1961, and tentatively approved by the Commissioners on March 30, 1961 (See Appendices "A", "B" and "C" to this opinion). The formula, however, is adopted, because, in the opinion of the Court, it is intrinsically the best suited under the facts and in view of the nature of the trade or business involved herein.

The parties have stipulated facts sufficient for the application of the foregoing formula.

The Court has not overlooked the decision in the Gallant case that the regulation providing a one factor formula of sales is valid in that case. That decision, however, must be considered in the light of the circumstances in that case, that is to say, that the taxpayer, Gallant Incorporated, was

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(19) Approved, 1957, by the National Conference of Commissioners on Uniform State Laws and by the American Bar Association.

engaged primarily in "the purchase and sale", and not "the manufacture and sale", with its principal office in the District, and sold the tangible personal property involved in that case within and without the District, which permitted the use of the sales factor only, without violating the letter of the directive in the Act that the income had to be treated as earned, or from sources within and without the District, which would not be true in this case where the products involved were manufactured without but sold within the District, [redacted]. The use of the one factor formula in the Gallant case did deprive the District of Columbia of some revenue, but not all, so that, strictly speaking as observed above, the formula did not violate the letter of the law. The same is true of the Southern Railway Co., Evening Star Newspaper Co. and Thompson's Dairy, Inc., cases.

IX

Computation of Taxes and Interest Due

Year 1957

The factors of property, payroll and sales as defined in the formula may be stated as follows:

	Everywhere	District of Columbia	District Percentage
(20) Property	$6,247,160,370	$ 1,360,676	.0218%
Payroll	$2,662,072,037	$ 1,268,180	.0477%
Sales	$9,461,855,874	$37,185,704	.3930%
Combined Percentages			.4625%
Total Percentages divided by 3 (average)			.1542%

The portion of petitioner's net income for 1957 fairly attributable to the business of manufacturing and selling its products carried on within the District is computed as follows:

(20) The item of "Property" includes both owned and rented property, the latter valued at 8 times the annual rent paid by petitioner.

Total Net Income.....	$1,312,092,839.00
Three Factor Apportionment Percentage...	.1542%
Net Income Apportioned to District.....$	2,023,247.00
Plus Other Net Income from Sources in the District.....	10,320.00
Total Net Income Taxable by District....	2,033,567.00
Rate of Tax.....	5%
Tax Due by Petitioner.....	101,162.25
Interest from 4/15/58 to 5/20/60 at ½ of 1% per month.(21).....	13,151.25
Total Tax and Interest Due for 1957.....$	114,313.50

Year 1958

The factors of property, payroll and sales as defined in the formula may be stated as follows:

	Everywhere	District of Columbia	District Percentage
Property	$6,403,673,576	$ 1,326,209	.0207%
Payroll	$2,354,049,741	$ 1,233,787	.0524%
Sales	$7,853,393,381	$32,542,519	.4144%
Total Percentages			.4875%
Total Percentages divided by 3 (average)			.1625%

The portion of the petitioner's net income for 1958 fairly attributable to business carried on within the District of Columbia by the petitioner is computed as follows:

Total Net Income.....	$653,396,893.00
Three Factor Apportionment Percentage..	.1625%
Net Income Apportioned to District.....$	1,061,769.00
Plus Other Net Income from Sources in the District.....	15,418.00
Total Net Income Taxable by District...	1,077,187.00
Rate of Tax.....	5%
Tax Due by Petitioner.....	53,859.35

(21) Section 47-1589c(b), D.C. Code, 1951 Edition, Supplement VIII, providing for interest on interest does not apply, because the amount assessed and demanded was exorbitant.

Interest from 4/15/59 to 5/20/60 at ½ of 1% per month.(22).....	$ 3,770.15
Total Tax and Interest Due for 1958...	$ 57,629.50

X

Computation of Refund

Year 1957

The amount of franchise tax and interest for the year 1957 to be refunded to the petitioner is computed as follows:

	Tax	Interest	Total
Originally and Voluntarily paid by Petitioner.....	$ 4,198.70	None	$ 4,198.70
Deficiency paid by Petitioner.....	268,585.40	$35,379.40	303,964.80
Total paid by Petitioner.....	$272,784.10	$35,379.40	$308,163.50
Amount due by Petitioner.....	101,162.25	13,151.25	114,313.50
Refund payable to Petitioner.....	$171,621.85	$22,228.15	$193,850.00

Year 1958

The amount of franchise tax and interest for the year 1958 to be refunded to the petitioner is computed as follows:

	Tax	Interest	Total
Originally and Voluntarily paid by Petitioner.....	$ 1,500.00	None	$ 1,500.00
Deficiency paid by Petitioner.....	167,468.44	$11,860.89	179,329.33
Total paid by Petitioner.....	$168,968.44	$11,860.89	$180,829.33
Amount due by Petitioner	53,859.35	3,770.15	57,629.50
Refund payable to Petitioner.....	$115,109.09	$ 8,090.74	$123,199.83

(22) Section 47-1589c(b), D. C. Code, 1951 Edition, Supplement VIII, providing for interest on interest does not apply, because the amount demanded in the assessment was exorbitant.

XI

Conclusion

For the reasons hereinbefore stated the Court holds as follows:

Docket No. 1698. That a deficiency in franchise tax for the calendar year 1957 in the amount of $171,621.85, and interest thereon in the amount of $22,228.15, or a total of $193,850.00, were erroneously assessed against and collected by the respondent from the petitioner; and that the petitioner is entitled to a refund thereof with interest thereon at the rate of 4 per centum per annum from May 20, 1960, to the date of the payment of the refund.

Docket No. 1699. That a deficiency in franchise tax for the calendar year 1958 in the amount of $115,109.09, and interest in the amount of $8,090.74, or a total of $123,199.83, were erroneously assessed against, and collected by the respondent from the petitioner; and that the petitioner is entitled to a refund thereof with interest thereon at the rate of 4 per centum per annum from May 20, 1960, to the date of the payment of the refund.

Decisions will be entered for petitioner.

Jo. V. Morgan,
Judge